Supreme Court, U. S.
FILED
AUG 22 1978
MICHAEL RODAK, JR., CLERK

# SUPREME COURT OF THE UNITED STATES

October Term, 1978

No. _____

78-293

**AVERY FEDERAL SAVINGS AND LOAN ASSOCIATION, et al. - - - Appellants**

*versus*

**WILLIAM D. MEYERS, et al., Commissioners of the Sinking Fund of the City of Louisville - - - - - - - Appellees**

---

**On Appeal from the Court of Appeals of Kentucky**

---

## JURISDICTIONAL STATEMENT

---

**GERALD KIRVEN**
**BROOKS ALEXANDER**
**MIDDLETON, REUTLINGER & BAIRD**
501 South Second Street
Louisville, Kentucky 40202
*Attorneys for the Appellants*

WESTERFIELD-BONTE CO., 619 W. KENTUCKY—P.O. BOX 3251, LOUISVILLE, KY.

## TABLE OF CONTENTS


PAGE

**Jurisdictional Statement** ..... 1

**Opinion Below** ..... 2

**Jurisdiction** ..... 2

**Questions Presented** ..... 5

**Statement of the Case** ..... 5

**The Federal Questions Presented Are Substantial** .... 8

This Court's cases preceding the enactment of the 1959 amendment to 31 U.S.C. §742 sanction an exception to that statute for nondiscriminatory franchise taxes imposed by states on corporations. The legislative history manifests that the amendment's purposes were to codify this Court's decisions and to forbid the inclusion of interest on United States obligations in the computation of state and local income taxes. The tax in question is a municipal income tax. The amended statute prohibits imposition of that tax upon interest on United States Government obligations. Failure of this Court to protect 31 U.S.C. §742 against the erosion presented by this case will invite all local and state governments to structure and label their existing income taxes in such a way as to join Louisville and Jefferson County in taxing interest on United States Government obligations.

**Conclusion** ..... 17

**Appendix A** ..... 19

**Appendix B** ..... 26

**Appendix C** ..... 27

**Appendix D** ..... 28

**Appendix E** ..... 36

**Appendix F** ..... 37

**Appendix G** ..... 38

**Appendix H** ..... 39

**Appendix I** ..... 41

## TABLE OF AUTHORITIES CITED


**Cases:** PAGE

*City of Lexington* v. *Motel Developers, Inc.*, Ky., 465 S. W. 2d 253 (1971) ..... 14–15
*City of Louisville* v. *Sebree*, 308 Ky. 420, 214 S. W. 2d 248 (1948) ..... 7–8, 13–14
*Cox Broadcasting Corp.* v. *Cohn*, 420 U. S. 469 (1975) ..... 4
*Educational Films Corp.* v. *Ward*, 282 U. S. 379 (1931) ..... 9
*Howard* v. *Commissioners of the Sinking Fund*, 344 U. S. 624 (1953) ..... 16
*King Manufacturing Co.* v. *Augusta*, 277 U. S. 100 (1928) ..... 4–5
*Lathrop* v. *Donohue*, 367 U. S. 820 (1961) ..... 5
*Macallen Co.* v. *Massachusetts*, 279 U. S. 620 (1929) . 12, 13
*Michigan-Wisconsin Pipeline Co.* v. *Calvert*, 347 U. S. 157 (1954) ..... 5
*Patrick* v. *City of Frankfort*, Ky., 539 S. W. 2d 275 (1976) ..... 15
*Werner Co.* v. *Director of Taxation*, 350 U. S. 492 (1956) ..... 9

**Constitutional Provisions, Statutes and Ordinances:**

Kentucky Constitution:
§110(b) ..... 3
§181 ..... 14
Kentucky Revised Statutes §91.260 ..... 14
R.S. §3701 (31 U.S.C. §742) ..... 1
4 U.S.C. §106 ..... 16
4 U.S.C. §110(c) ..... 16
28 U.S.C. §1257(2) ..... 4, 5
28 U.S.C. §1257(3) ..... 5
28 U.S.C. §2103 ..... 5
31 U.S.C. §742 ..... 3, 4, 5, 6, 7, 8, 10, 16, 17
General Ordinances of the City of Louisville:
§727.01(j) ..... 2, 11
§727.02 ..... 2, 4, 6, 11





PAGE

**Kentucky Rules of Civil Procedure ("CR"):**

CR 75.04 ..... 7
CR 76.20(9)(c) ..... 4
CR 76.30(1) ..... 4

**Miscellaneous:**

Kentucky Tax Reports, Commerce Clearing House, Paragraph 72-700 ..... 16
Legislative History of 31 U.S.C. §742 ..... 10
Letter from Sinking Fund counsel to the trial judge ..... 6, 12–13
Occupational License Return, City of Louisville; Jefferson County, Kentucky; Mass Transit; School Boards ..... 6, 11

# SUPREME COURT OF THE UNITED STATES

**October Term, 1978**

**No. _____**

---

AVERY FEDERAL SAVINGS AND LOAN ASSOCIATION, et al. - - - - *Appellants*

*v.*

WILLIAM D. MEYERS, et al., Commissioners of the Sinking Fund of the City of Louisville - - - *Appellees*

---

ON APPEAL FROM THE COURT OF APPEALS OF KENTUCKY

---

## JURISDICTIONAL STATEMENT

---

Because R.S. §3701, 31 U.S.C. §742, prohibits municipalities from taxing United States Government obligations and the interest thereon, nine federal savings and loan associations of Louisville, Kentucky, (the "associations") bring this appeal from the portion of a decision of the Court of Appeals of Kentucky upholding the validity of Louisville and Jefferson County, Kentucky, taxes upon interest on United States Government obligations.

To permit the decision of the Kentucky Court of Appeals to stand would allow local tax authorities in

Kentucky and throughout the country to tax interest on United States Government obligations by means which the statute prohibits.

## OPINION BELOW

The opinion of the Court of Appeals of Kentucky was not published. It is set forth in Appendix A.

## JURISDICTION

The associations, as plaintiffs, on October 23, 1974, filed a declaratory judgment action in the Jefferson Circuit Court to determine whether they were obligated to pay a tax upon their net profits imposed by §727.02 of the General Ordinances of the City of Louisville. The definition of "net profit" is contained in §727.01 (j) and is essential to a construction of §727.02.

Defendants were the then five incumbent Commissioners of the Sinking Fund of the City of Louisville (the "Sinking Fund"). The Sinking Fund is charged with the collection of the taxes for the City of Louisville and the similar taxes levied by Jefferson County on behalf of itself and the school board. Since the county resolutions which impose these latter taxes are identical to the city ordinances, only the relevant city ordinances are set forth in Appendix B.

Although it had allowed all other taxpayers to deduct interest on United States Government obligations, in the course of the proceedings in the trial court, the Sinking Fund asserted the right to tax the associations on such interest, thereby increasing the associations' alleged tax liability by $464,472, exclusive of interest and penalties. On May 25, 1975, the associations amended their complaint to rely expressly upon 31 U.S.C. §742 as prohibiting the Sinking Fund's attempt to tax interest on United States Government obligations. The text of 31 U.S.C. §742 is set forth in Appendix C.



The trial court entered summary judgment in favor of the Sinking Fund on November 12, 1975, expressly holding that the associations were not entitled to deduct interest on federal obligations in computing their tax liability. The trial court's findings of fact, conclusions of law, and judgment are set forth in Appendix D.

After hearing the associations' appeal, the Court of Appeals of Kentucky, on November 25, 1977, rendered its opinion reversing the portion of the trial court's judgment which found the Sinking Fund not to be guilty of discrimination against the associations and remanding the issue of discrimination for trial but affirming the portion of the judgment which holds that 31 U.S.C. §742 does not bar imposition of the tax on interest on United States Government obligations. That court on February 24, 1978, denied the associations' petition for rehearing. The order is set forth in Appendix E.

Under §110(b) of the Constitution of Kentucky, the associations had no appeal, as of right, to the Supreme Court of Kentucky. The Kentucky Supreme Court denied the associations' motion for a discretionary review on June 6, 1978, the order of denial reciting that "the decision stands affirmed." That order is set forth in Appendix F.

When a motion for discretionary review is denied by the Supreme Court of Kentucky, no further proceedings are allowed in that court. Kentucky Rules of Civil Procedure ("CR"), 76.20(9)(c).

The Court of Appeals of Kentucky, after disposition of an appeal, does not enter a judgment but a mandate, "which makes effective the opinion disposing of the appeal." CR 76.30(1). After the Supreme Court of Kentucky denied the associations' motion for discretionary review, the Court of Appeals issued its mandate on June 29, 1978. The mandate is set forth in Appendix G.

Regardless of the outcome of the discrimination issue in the trial court, the federal issue of the right of Louisville and Jefferson County to tax interest on United States Government obligations will survive and require decision in this Court. *Cox Broadcasting Corp.* v. *Cohn,* 420 U. S. 469, 480 (1975). The associations have thus exhausted their remedies in the Courts of Kentucky on this federal issue.

The associations filed a Notice of Appeal to this Court in the Kentucky Court of Appeals on July 7, 1978. The Notice of Appeal is set forth in Appendix H.

The jurisdiction of this Court is invoked pursuant to 28 U.S.C. §1257(2). Since the Court of Appeals of Kentucky upheld the validity of §727.02 of the General Ordinances of the City of Louisville which had been drawn in question as repugnant to 31 U.S.C. §742, this matter is appropriately brought to this Court by appeal. The ordinance is a statute of the state within the meaning of 28 U.S.C. §1257(2). *King Mfg. Co.* v. *Augusta,* 277 U. S. 100, 114 (1928). Similarly, the effort of the Sinking Fund to collect the tax is state action within the meaning of 28 U.S.C. §1257(2). *Lathrop* v. *Donohue,* 367 U. S. 820, 824 (1961). The associations properly appeal from the decision of the Court of Appeals of Kentucky, since they tried but were unable to take their case higher in the Kentucky court system. *Michigan-Wisconsin Pipeline Co.* v. *Calvert,* 347 U. S. 157, 160 (1954).



If this Court does not consider appeal to be the proper method of review, the associations request that this document be treated as a petition for a writ of certiorari pursuant to 28 U.S.C. §§1257(3) and 2103.

## QUESTIONS PRESENTED

The questions now presented are these:

(1) In the context of 31 U.S.C. §742, is the tax in question an income tax?

(2) Does 31 U.S.C. §742 prohibit Louisville and Jefferson County from imposing this tax upon interest on United States Government obligations?

## STATEMENT OF THE CASE

In 1948, the City of Louisville, by ordinance, first imposed an annual tax of 1% of the gross wages of persons employed and 1% of the net profits of businesses in the city. Later Jefferson County levied similar taxes for itself and the school board. The tax rates for the city and county are now 1¼% each and the school board ¾%.

For many years, the Sinking Fund made no attempt to collect any tax on the net profits of any savings and loan association. The associations filed this declaratory judgment suit after the Sinking Fund began efforts to collect net profits taxes from the associations.

When the associations filed their declaratory judgment action on October 23, 1974, they sought exemption from *any* tax liability under §727.02 of the Louisville ordinance.

While this action was proceeding in the trial court, on May 12, 1975, counsel for the Sinking Fund wrote the trial judge that the Sinking Fund had decided to collect taxes from the associations "on their full net income without granting them a deduction for interest on federal obligations." Until then, the Sinking Fund had never compelled the associations or any other taxpayers to pay taxes on interest on federal obligations. In fact, the very tax forms printed by the Sinking Fund for the tax years before, during, and after the years in question through 1977 expressly allowed all taxpayers to deduct interest on United States Government obligations from net profits subject to tax. Page 2, Schedule 3, item G, of the return allows this deduction. A copy of the tax return form is set forth in Appendix I.

There was thus introduced into the litigation the Sinking Fund's claim that interest on federal obligations is subject to the tax. On May 29, 1975, the associations filed their amended complaint expressly asserting that 31 U.S.C. §742 prohibits the Sinking Fund's attempt to tax interest on United States Government



obligations. The filing of the amended complaint was the stage in the proceedings in the court of first instance in which the federal questions sought to be reviewed were raised. The Sinking Fund answered the amended complaint, joining the issue on the federal questions.

The trial court entered findings of fact, conclusions of law and summary judgment in favor of the Sinking Fund on November 12, 1975. In law conclusion 12, the court found 31 U.S.C. §742 no bar to the tax and in paragraph 3 of the judgment held the associations not entitled to deduct interest on federal obligations in computing their tax liability. (Appendix D.)

The associations filed a timely notice of appeal from the trial court's judgment. They were free in their appeal to argue any trial court error without any "assignment of errors" under CR 75.04, as then in effect. Their appellate briefs included arguments about the nature of the tax on net profits and asserted that 31 U.S.C. §742 prohibited taxation of net profits to the extent they were derived from interest on United States Government obligations.

The Court of Appeals of Kentucky on November 25, 1977, reversed the portion of the trial court's judgment which found the Sinking Fund had not discriminated against the associations and remanded that issue for trial but affirmed the portion of the judgment which held the associations subject to the tax. The court rejected the associations' argument that the ordinance imposes an income tax saying: "This argument was laid to rest in *City of Louisville* v. *Sebree,* 308 Ky. 420, 214 S. W. 2d 248 (1948). Sebree has not been

overruled. We regard this as controlling." (Opinion, p. 22.) The court concluded that 31 U.S.C. §742 "is no impediment to the collection of the tax." (*Id.*, p. 23.) The court held that the associations "are subject to the tax and . . . the tax may be levied upon interest on federal securities." (*Id.*, p. 25.) The court sustained the associations' contention that the tax may not be levied on dividends from Federal Home Loan Bank stock. (*Ibid.*) (The opinion is found in Appendix A.)

## THE FEDERAL QUESTIONS PRESENTED ARE SUBSTANTIAL

This appeal presents a very substantial federal question. The ambiguity of the language of the 1959 amendment to 31 U.S.C. §742 has allowed increasingly aggressive local taxing authorities in effect to repeal 31 U.S.C. §742 as to corporate taxpayers. This Court's cases preceding the enactment of the 1959 amendment and the amendment's legislative history manifest two purposes of the 1959 amendment. One purpose was to codify this Court's several decisions which had sanctioned an exception to 31 U.S.C. §742 for nondiscriminatory franchise taxes imposed by states on corporations. A second purpose was to counter a certain state's attempt to include interest on U. S. obligations in the computation of the state's net income tax. Failure of this Court to protect 31 U.S.C. §742 against its erosion presented by this case will invite every city, county, and other form of local government to impose any type of nonproperty tax on interest on U. S. Government obligations and both such local governments and the



states themselves to subject such interest to their income taxes.

The decisions of this Court do not justify inclusion of the tax in question within the exemption of the 1959 amendment.

*Educational Films Corp.* v. *Ward,* 282 U. S. 379 (1931) involved a New York state statute imposing on corporations a "franchise tax" for "the privilege of exercising its franchise in this state." In upholding the tax, this Court emphasized at page 388 that it was a franchise tax and not an income tax:

> "If we look to the operation of the present statute, it is plain that it can have no application independent of the corporation's enjoyment of the privilege of exercising its franchise. If appellant had ceased to do business before November 1, 1929, it would not have been subject to any tax under this statute, although it had received, during its preceding fiscal year, income which the statute makes the measure of the tax. Since it can be levied only when the corporation both seeks or exercises the privilege of doing business in one year and has been in receipt of net income during its preceding fiscal year, the tax, whatever descriptive terms are properly applicable to it, obviously is not exclusively on income apart from the franchise."

*Werner Co.* v. *Director of Taxation,* 350 U. S. 492 (1956) involved the imposition by the State of New Jersey on domestic corporations of " 'an annual franchise tax . . . for the privilege of having or exercising its corporate franchise' in the State." That tax,

measured by corporate net worth, was clearly not an income tax and the Court held that the inclusion of the value of certain federal bonds in the taxpayers' "net worth" was not prohibited by 31 U.S.C. §742.

The legislative history of the 1959 amendment demonstrates that Congress did not intend for it to be interpreted to encompass the tax in question. The amendment was adopted to counter the position of one state with respect to the inclusion of interest on obligations of the United States in the computation of that state's net income tax.

> "Present law provides that obligations of the United States are to be exempt from taxation by or under State or local authority. The Supreme Court has held that this includes the exemption of interest on U. S. obligations from taxation by or under State or local authority. *It has been pointed out to your committee, however, that one State has taken the position that the statute as now worded does not prohibit a State from including interest on Federal obligations in computing 'gross income' upon which taxable net income is determined.* The bill (sec. 105) makes it clear that the exemption for Federal obligations extends to every form of taxation that would require either the obligation, or the interest on it, or both to be considered directly or indirectly in the computation of the tax, except nondiscriminatory franchise taxes (or other nondiscriminatory non-property taxes imposed in lieu thereof) on corporations and except estate or inheritances taxes." [H.R. Rep. 1148, 86th Cong., 1st Sess., p. 8 (1959); S. Rep. No. 909, 86th Cong., 1st Sess., p. 8 (1959)] (Emphasis added.)



In fine, Congress enacted the amendment to clarify the statutory prohibition against state and local authorities' levying income taxes upon interest on United States Government obligations.

The 1959 amendment codified this Court's decisions excepting nondiscriminatory franchise taxes imposed by states on a corporation for the privilege of exercising its franchise in the state. The tax in question is neither imposed by a state nor is it a franchise tax. In fact, this tax is patently an income tax imposed by a city and a county.

The ordinance imposes the tax on the "net profits of all businesses" (§727.02).

"Net profit" is defined by the ordinance to mean "the net income from the operation of a business . . . after provision for all costs and expenses incurred in the conduct thereof, and shall be the same as reported for federal income tax purposes, excluding items exempted under this chapter, but without deduction of any taxes based on income or any operating loss carryovers or carrybacks" (727.01(j)).

Inspection of the tax return form (Appendix I), page 1, part II, section B, lines 1-5, demonstrates how this is a tax upon income reported for federal income tax purposes. A corporate taxpayer, such as the associations, simply copies income and deductions reported on its federal form 1120 on lines 1 and 2, enters the difference on line 3, enters the adjustments on line 4, and computes its "Adjusted Net Profit" on line 5. This is the figure against which the Louisville, Jefferson County and school board tax rates are applied to determine the tax due.

The record of this case gives examples of how clearly income is the sole determinant of this tax. Convenient Industries of America, Inc., and Threadbare, Inc., "engaged in business in the city and county" but, since they did not have "net profits" (*i.e.*, they had a net loss for federal income tax purposes), they incurred no liability for the tax in question.

The direct burden of the tax upon interest on federal obligations is vividly illustrated in this case. Early in the trial court proceedings the Sinking Fund conceded that two associations, Colonial and Lincoln, had no liability for this tax. At that time the Sinking Fund allowed all taxpayers to deduct interest on United States Government obligations. So much of the income of Colonial and Lincoln was derived from this interest that, with the deduction, these two associations had no "net profit" subject to tax.

The direct impact of the tax upon this interest is inescapable when it is seen that, when the Sinking Fund changed its position by refusing to allow the deduction, these two associations were deemed to owe a tax and the alleged total liability of the nine associations was increased by $464,472, exclusive of interest and penalties.

Furthermore, this case involves the type of specific singling out of federal obligations for taxation as this Court condemned in *Macallen Co.* v. *Massachusetts,* 279 U. S. 620 (1929).

During the course of this case when the Sinking Fund decided to levy the tax against interest on United States Government obligations, its counsel wrote a letter to the trial court stating:



> "[T]he Sinking Fund now wishes to assess and collect occupational license fees from the plaintiffs for the years in question in this suit on their full net incomes without granting them a deduction for interest on federal obligations."

*Macallen* involved an amendment to a Massachusetts tax statute while the instant case involves a change of policy by the Sinking Fund. The following language of *Macallen,* at 631-2 of 279 U. S., fits this case exactly:

> "In the present case, it appears that the original statute exempted from consideration as a part of the measure of the tax all interest upon the nontaxable securities. The amended act now in force has the effect of repealing this original provision and imposing a burden upon the securities from which, by express language, they had theretofore been free. This was a distinct change of policy on the part of the Commonwealth, adopted, as though it had been so declared in precise words, for the very purpose of subjecting these securities *pro tanto* to the burden of the tax." (Emphasis by the Court.)

Also, forcefully illustrating that the tax is an income tax is the fact that, until 1962, the associations, being exempt from federal income tax, "did not report any net profits on federal income tax returns and were exempt from the occupational tax by the wording of the ordinance." (Opinion of the Court of Appeals of Kentucky, p. 21, Appendix A.)

The Court of Appeals of Kentucky devoted none of its opinion to an analysis of the nature of the tax and simply recited that *City of Louisville* v. *Sebree,* 308 Ky.

420, 214 S. W. 2d 248 (1948), had laid the issue to rest. (*Id.* at p. 22.)

In *Sebree,* a hurried test case decided only 37 days after the effective date of the tax, the Kentucky Court of Appeals ruled that this tax was not an income tax in order to uphold its validity. Both the constitution (§181) and a statute (KRS 91.260) of Kentucky prohibit the imposition of an income tax by a city or county. Following the Kentucky court's determination of its validity, other cities and counties throughout Kentucky adopted taxing statutes patterned after this tax. By the time the justices of the Kentucky high court had an opportunity to observe the tax in operation, the tax had become so entrenched throughout the commonwealth, that the justices, while willing to admit that the tax was an income tax, were unwilling to invalidate it for fear of the disruptive effect such invalidation would have on the various city and county governments which had adopted the tax.

The concurring opinion (Judge Osborne joined by Judges Reed and Neikirk) in *City of Lexington* v. *Motel Developers, Inc.,* Ky., 465 S. W. 2d 263 (1971) states that:

> "There can no longer be any doubt but what this Ordinance imposed an income tax practically identical to that imposed by the federal government. It was attacked in the courts and this court in a lengthy, utterly confusing, opinion held the tax to be a license tax. See City of Louisville v. Sebree, *supra.*"
>
> . . .
>
> "In retrospect it now appears that there is little doubt but what the occupational tax as was enacted by the City of Louisville in Ordinance 83, Series 1950, was in violation of Section 181. However, this court found otherwise. Based upon that decision, many other cities have adopted either highly similar or identical taxes. For us to recant at this time and declare that type ordinance invalid would be to invalidate practically all occupational license taxes in this Commonwealth. I do not believe this is a course that is practical nor would it demonstrate the degree of wisdom that the people have a right to expect from their judicial officials. The die is now cast and I will not disturb these taxes." *Id.* at 264-5.



The concurring opinion in *Patrick* v. *City of Frankfort,* Ky., 539 S. W. 2d 275 (1976) (Justice Stephenson joined by Justice Jones) states:

"I admire the intellectual clarity of the trial court in the statement that the occupational tax is not unconstitutional 'only because the Court of Appeals has said so.' In my view, the occupational tax, despite the semantic legerdemain in prior opinions, is an *income tax* and clearly contravenes Section 181 of the Kentucky Constitution.

"The *Sebree* case represents expediency for laudable reasons. I would not have voted for the opinion. However, I am painfully aware of the fiscal chaos which would result in municipalities, great and small, throughout the Commonwealth if we should invalidate those occupational tax ordinances now in effect. I would say, we should not in the future depart from the plain provisions of Section 181." (539 S. W. 2d at 278, emphasis by Justice Stephenson.)

No fiscal chaos will result from a decision in this case that this tax is an income tax for purposes of 31 U.S.C. §742 since the Sinking Fund here is attempting to add interest on United States Government obligations to its preexisting tax base. This appeal does not seek general invalidation of any Kentucky municipal tax ordinances.

The tax is so clearly an income tax that Commerce Clearing House, a national legal publishing company, at paragraph 72-700 of its "Kentucky Tax Reports" states: "Below is set forth a digest of the occupational license, or income tax, imposed by Chapter 727, Code of Louisville."

This Court has held the City of Louisville tax to be an income tax when tested by federal law (the Buck Act, 4 U.S.C. §§106 and 110(c)). *Howard* v. *Commissioners of the Sinking Fund*, 344 U. S. 62 (1953).

Once again the question is, What kind of tax is this, tested by federal law (31 U.S.C. §742)?

The importance of the federal question is the need for a definitive decision to prevent this erosion of 31 U.S.C. §742. If the exception of the 1959 amendment is allowed to cover this tax, then there will be no city, county or state income tax that cannot be structured and labeled to fit the 1959 amendment.



## CONCLUSION

The decision of the Court of Appeals of Kentucky sustaining the tax on interest on federal obligations increases the associations' tax liability by $464,472, exclusive of interest and penalties. Large as this sum is, the more significant fact is that the Court of Appeals of Kentucky has sanctioned municipal violations of (1) the time-honored principle that federal obligations are exempt from local income taxation and (2) 31 U.S.C. §742, a federal statute requiring the exemption in this instance.

Unless this Court should summarily reverse the decision below, briefs on the merits and oral argument are indispensable to an understanding of the Louisville tax, especially since this Court has never written an opinion interpreting the 1959 amendment of 31 U.S.C. §742.

This Court should note probable jurisdiction and reverse the decision of the Court of Appeals of Kentucky.

Respectfully submitted,

GERALD KIRVEN
BROOKS ALEXANDER
MIDDLETON, REUTLINGER & BAIRD
501 South Second Street
Louisville, Kentucky 40202
(502) 584-1135
*Attorneys for Appellants*

September 1, 1978

# APPENDIX



## APPENDIX A

OPINION RENDERED: NOVEMBER 25, 1977
NOT TO BE PUBLISHED

## COURT OF APPEALS OF KENTUCKY

---

**CA-219-MR**

AVERY FEDERAL SAVINGS AND
LOAN ASSOCIATION, ET AL. - - - - *Appellants*

*Appeal from Jefferson Circuit Court*
*v. Honorable James A. Hubbs, Judge*
*192965*

WILLIAM D. MEYERS, ET AL. - - - - - *Appellees*

---

AND: **CA-348-MR**

FIRESIDE GREATER KENTUCKY SAVINGS AND
LOAN ASSOCIATION - - - - - - *Appellant*

*Appeal from Jefferson Circuit Court*
*v. Honorable James A. Hubbs, Judge*
*192965*

WILLIAM D. MEYERS, ET AL. - - - - - *Appellees*

---

AND: **CA-349-MR**

SOUTHERN FEDERAL SAVINGS AND
LOAN ASSOCIATION - - - - - - *Appellant*

*Appeal from Jefferson Circuit Court*
*v. Honorable James A. Hubbs, Judge*
*192965*

WILLIAM D. MEYERS, ET AL. - - - - - *Appellees*

---

**REVERSING CA-219-MR**
**AFFIRMING CA-348 & 349-MR**

BEFORE: VANCE, WILHOIT and WINTERSHEIMER, Judges.

VANCE, JUDGE: The question at issue is whether savings and loan associations are subject to the occupational license taxes levied by Louisville and Jefferson county, and, if so, whether interest income on federal securities is subject to the tax. There are collateral issues as to whether the attempted collection of the taxes from appellants is unconstitutionally discriminatory.

In 1948 the City of Louisville enacted an occupational license tax imposing a fee upon the *net profits* of all businesses, professions or occupations from activities conducted in the city. Subsequent occupational license taxes were levied for the benefit of Jefferson County, the school systems and the Transit Authority of River City. The briefs have dealt largely with the City of Louisville tax because its disposition will determine the result in the other cases.

The Louisville ordinance defines "business" as an enterprise, activity, profession of undertaking of any nature but excludes the usual activities of Boards of Trade, Chamber of Commerce, trade associations or unions and corporations or associations organized and operated for civic purposes where no part of the earnings or income or receipts of such groups or associations inures to the benefit of any private stockholder or individual.

Net profit was defined as the net income from the operation of a business or enterprise and shall be the same as reported for federal income tax purposes.

The appellants are all federal savings and loan institutions organized under The Homeowners Loan Act of 1933. They operate with funds received from depositors who are paid interest on their deposits. Their business, in the main part, consists in the making of loans for the construction of single family residences. The membership of the associations consists of all those persons who are either depositors



or borrowers. The members elect boards of directors who manage the affairs of the associations.

The agency responsible for the collection of the occupational tax is the Sinking Fund, whose commissioners are designated as appellees. From the date of the enactment of the ordinance until the commencement of this litigation national and state banks, credit unions, production credit associations, banks for cooperatives and savings and loan associations have not been required to file occupational license tax returns. The exemption of the savings and loan associations from the requirements of the tax has a peculiar history. Until 1962 savings and loan associations were exempt from federal income tax by the Internal Revenue Code. Thus until 1962 they did not report any net profits on federal income tax returns and were exempt from the occupational tax by the wording of the ordinance.

In 1964 the Attorney General of Kentucky issued an opinion that savings and loan associations were exempt from license taxes by virtue of KRS 136.300, the pertinent part of which is as follows:

> The association shall not be required to pay local taxes upon its capital stock, surplus, undivided profits, notes, mortgages or other credits, and the tax provided by this section shall be in lieu of all taxes for state purposes on property of the association.

In 1971, the Attorney General (OAG-71-518) withdrew his previous opinion and concluded that savings and loan associations were subject to local license taxes. Because of this opinion the commissioners of the Sinking Fund then commenced an effort to collect the occupational license tax from appellants.

No effort was made in the beginning to collect a tax upon interest income from United States securities. Organizations and persons who were not exempt from filing an

occupational license tax had been allowed a deduction for interest earned on federal securities. The occupational license return form provided for the deduction in every year applicable except 1968. In 1968 the commissioners determined that the tax should be assessed on federal interest but, due to a large number of protests and a contrary legal opinion, changed their mind. No effort was made to collect the tax on interest in 1968 or any subsequent year until the commencement of this action.

I. Are Savings and Loan Associations Subject to the Occupational License Tax.

Appellants contend they are not subject to the tax for a variety of reasons. The first reason offered is that the license tax ordinance is unconstitutional because it imposes an income tax which is prohibited to cities. This argument was laid to rest in *City of Louisville* v. *Sebree,* 308 Ky. 420, 214 S. W. 2d 248 (1948). Sebree has not been overruled. We regard this as controlling.

Appellant next asserts exemption from the tax upon the basis of KRS 136.300. We concur with the 1971 opinion of the Attorney General that appellants are subject to the tax. The ordinance does not levy a tax upon capital stock, surplus, undivided profits, notes, mortgages or other credits which are the only items excluded from local taxes.

Appellants next contend that under the definitions contained in the ordinance, they could be subject to the tax only if they can be classified as "businesses" but that they are not businesses because the definition of "business" excludes corporations and associations organized for "civic purposes." Appellants claim to be civic organizations no part of whose earnings inure to the benefit of any private shareholder or individual.

It is admitted however that all depositors are paid interest on their deposits and that the depositors are members



of the associations. One aspect of the operation of the associations is to provide capital for construction of homes but another aspect is to provide a means for the investment of the members' capital funds. We are not convinced the exclusion applicable to civic enterprises was intended to exempt appellants from the tax.

Having determined that appellants are subject to the tax, the next question is whether their income received from United States securities is subject to the tax.

The Internal Revenue Code, 31 U.S.C., Section 742, exempted obligations of the United States and the interest thereon from local taxation. In 1959 section 742 was amended to permit the levy of "nondiscriminatory franchise taxes" on corporations in lieu of other taxes upon federal obligations.

Appellants are corporations and would have been subject to a non-discriminatory tax upon interest earned on federal obligations since 1959 except for the fact that they were exempt as shown earlier in this opinion because they were not subject to an income tax until 1962.

Since 1962 there has been no impediment to the collection of the tax unless, as argued by appellants, the tax is discriminatory. The basis of the alleged discrimination is that there has been no attempt to collect the tax from national or state banks, credit unions, production credit associations, or banks for cooperatives. In fact, there does not appear to have been any effort to collect the tax on interest on federal obligations from any type of corporation.

The exemption for banks is mandated by KRS 316.270. We hold the separate classification of banks is not unreasonable.

Credit unions are exempt from local taxation by KRS 290.300 and 12 *U.S.C.,* Section 1768. We find no reason, however, to exempt production credit associations and banks for cooperatives and indeed all other private corporations while attempting to impose the tax upon appellants

alone. It seems undisputed that until sometime after this litigation was begun, the appellees believed that everybody was entitled to a deduction for interest on United States obligations and that they did not seek to collect that tax from anyone. During the course of the litigation appellees have come to the belated realization that they could have imposed the tax upon appellants and other corporations for years—but the effort to collect the tax on interest has been limited to appellants and three state savings and loan associations.

The record does not reveal the extent to which other corporations may have had taxable income on federal securities.

It may be that further evidence would show the liability for tax on the part of other corporations against whom there is now no effort to collect the tax is so trivial that the failure to pursue them does not constitute invidious discrimination. On the other hand, if there are substantial numbers of other incorporations that are subject to the tax but are not being pursued, the enforcement of the tax is discriminatory. The appellees cannot deliberately limit the application of a general tax to one class of taxpayers.

We find no merit in the contention that the enforcement is barred by limitations or issue preclusion. There is merit to the contention that the tax should not apply to dividends on Federal Home Loan Bank stock. The Federal Home Loan Bank Act of 1932 specifically exempts from taxation the bank and its capital. This exemption would apply to dividends on the capital stock.

Fireside Greater Kentucky Savings and Loan Association and Southern Federal Savings and Loan Association appeal from orders denying intervention after the final judgment was entered.

Each of these appellants knew of the pending litigation and could have participated in it before judgment. They offer no good reason for failing to do so. We think their



motion to intervene was not timely and the trial court properly denied intervention.

The issues as to whether appellants are subject to the occupational license taxes and whether or not such taxes may be levied upon the interest received from United States securities seem to be purely questions of law as to which there is no genuine issue of fact. Summary judgment as to those issues was proper and we affirm the judgment of the trial court that appellants are subject to the tax and that the tax may be levied upon interest on federal securities.

There appears to be a genuine issue of fact as to whether appellees are seeking to enforce the tax against appellants in a discriminatory manner. Summary judgment therefore as to liability of appellants for the payment of the tax is premature.

The judgments in appeals Nos. CA-348-MR and CA-349-MR are affirmed. The judgment in appeal No. CA-219-MR is reversed for further proceedings in conformity with this opinion.

ALL CONCUR.

## APPENDIX B

### GENERAL ORDINANCES OF THE CITY OF LOUISVILLE

727.02 On Whom Imposed; Amount.

On and after January 1, 1959, every person, association, corporation or other entity engaged in any occupation, business, trade, profession or other activity in the City shall pay into the Sinking Fund an annual license fee for the privilege of engaging in said activities, which license fee shall be measured by one and one-fourth (1¼%) per cent of (a) all salaries, wages, commissions and other compensation earned by every person in the City for work done or services performed or rendered in the City; and (b) the net profits of all businesses, professions or occupations from activities conducted in the City. (1958 G.O. Sec. 67-1.)

727.01 Definitions.

. . .

(j) "Net profit" shall mean the net income from the operation of a business, or enterprise, after provision for all costs or expenses incurred in the conduct thereof, and shall be the same as reported for federal income tax purposes, excluding items exempted under this chapter, but without deduction of any taxes based on income or any operating loss carryovers or carrybacks. (Ord. 114-1971. Approved 8-14-71.)

. . .



## APPENDIX C

### 31 UNITED STATES CODE § 742:

Exemption From Taxation.

Except as otherwise provided by law, all stocks, bonds, Treasury notes, and other obligations of the United States, shall be exempt from taxation by or under State or municipal or local authority. This exemption extends to every form of taxation that would require that either the obligations or the interest thereon, or both, be considered, directly or indirectly, in the computation of the tax, except nondiscriminatory franchise or other nonproperty taxes in lieu thereof imposed on corporations and except estate taxes or inheritance taxes.

R.S. § 3701; Sept. 22, 1959, Pub. L. 86-346, Title 1, § 105(a), 73 Stat. 622.

## APPENDIX D

# JEFFERSON CIRCUIT COURT

CHANCERY BRANCH, SECOND DIVISION

**No. 192965**

---

AVERY FEDERAL SAVINGS AND LOAN ASSOCIATION, ET AL. - - - *Plaintiffs*

*v.*

WILLIAM D. MEYERS, ET AL. - - - *Defendants*

---

## FINDINGS OF FACT, CONCLUSIONS OF LAW AND JUDGMENT

### FINDINGS OF FACT

1. An actual justiciable controversy exists between the parties herein.

2. The Plaintiffs filed a suit for a Declaration of Rights concerning the applicability of the Louisville occupational license tax to their savings and loan operations in the City.

3. By way of Amended Answer, filed with leave of Court, Defendants brought into issue the applicability of the county and school license taxes to the operations of the Plaintiff associations, all taxes being based upon similar language found either in City ordinance or County fiscal court resolution. Additionally the applicability of the Transit Authority of River City ("TARC") tax will be governed by the Court decision in this case because of similar language found in the City Ordinance and (or) County Fiscal Court Resolution levying such tax.



4. By way of Amended Complaint Plaintiffs put into issue the question of deductibility of interest received by Plaintiffs on obligations of the United States. Defendants by way of Answer to Amended Complaint denied the deductibility of said interest, and thus the issue became joined.

5. The nine Plaintiffs are all federally chartered savings and loan associations organized under Section 5 of the Homeowners' Loan Act of 1933, as amended (12 U.S.C. §1464). As such, the Plaintiffs are federally chartered membership corporations owned by their depositors and borrowers who constitute their membership and who have the exclusive right to elect their boards of directors which in turn manage the affairs of the Plaintiffs.

6. The individual Defendants in this action together constitute all of the Commissioners of the Sinking Fund of the City of Louisville, Kentucky, and have been sued in their official capacity as such. As such the Commissioners of the Sinking Fund are charged by statute, ordinance and appropriate County Fiscal Court resolution, with the responsibility of collecting the occupational license taxes for the City of Louisville, County of Jefferson, Jefferson County Schools and TARC.

7. The said Plaintiffs have business addresses in the City of Louisville, County of Jefferson, Kentucky and are carrying on the business of savings and loan associations at said addresses.

8. Said operations include the receipt and disbursement of savings deposits, the payment of interest on the same, the making and servicing of mortgage loans, the purchase and sale of obligations of the United States and related activities.

9. The Plaintiffs pay local ad valorem taxes on their real and tangible personal property and the tax of $1.00 per $1,000.00 of paid-in capital to the State of Kentucky

under KRS 136.300. The Plaintiffs also pay federal corporate income taxes.

10. Defendants have not discriminated against federally chartered savings and loan associations in favor of state chartered savings and loan associations. The attempts to impose the appropriate occupational license taxes against the Plaintiffs resulted in the filing of this Declaration of Rights suit, and said Defendants continue to seek to impose the occupational license taxes in the same manner and amount against state chartered institutions of like nature. Any exclusion or omission of an association has not been proven intentional on the part of the Defendants. In 1975 the Defendants secured statute of limitations waivers from all known savings and loan associations, federal and state, not included in this lawsuit, to preserve their right to collect license taxes pending the result of this particular litigation. Prior to the institution of this suit, Defendants in 1974 secured waivers from all savings and loan associations known to it in the City and County.

11. The operation and organization of banks, credit unions, banks for cooperatives and production credit associations as defined and established in the appropriate statutes concerning them are different and distinctive from the operation and organization of savings and loan associations. Mutual savings banks do not exist in Kentucky.

12. For federal income tax purposes the said Plaintiffs have been including in their income interest received on federal obligations. The Defendants in computing the occupational license taxes due and owing the city, county, school district and TARC, if Plaintiffs are subject to said taxes, have calculated the total tax liability with the inclusion of said interest.

13. The record indicates that with the exception of 1968 the Commissioners of the Sinking Fund have uniformly permitted the deduction of interest on federal obligations



to all taxpayers. Defendants now state that they have been in error in permitting this deduction to corporate taxpayers, and the question is before the Court for resolution.

## CONCLUSIONS OF LAW

1. This action for Declaration of Rights is properly brought under KRS 418.040, and the Court has jurisdiction of the parties. No genuine difference exists as to any material fact and the case is accordingly proper for decision by summary judgment under C.R. 56.

2. The City occupational license tax is levied pursuant to KRS 91.200 and 92.281. The County occupational license tax is levied pursuant to KRS 68.180. The occupational license tax for schools is levied pursuant to KRS 160.484 and 160.605. The occupational license tax for TARC is levied pursuant to KRS 96A.320.

3. Louisville has imposed and provided for the levy and collection of the City occupational license tax authorized by the above-cited statutes by means of the ordinances comprising Chapter 727 of the Codified General Ordinances of the City. The three other occupational license taxes have been imposed pursuant to the respective statutes authorizing them by appropriate resolutions and orders adopted by the Fiscal Court of Jefferson County.

4. The savings and loan operations carried on by said Plaintiffs at their respective places of business in the City of Louisville and branch offices in the County of Jefferson constitute the engaging in an occupation, business, trade or other activity in the City within the meaning of Ordinance 83, Series 1950, Section 727.02 of the Codified Ordinances of the City of Louisville and the appropriate County resolutions.

5. The conduct by the Plaintiffs of their savings and loan operations in the City and County constitutes a business within the meaning of the same ordinance of 1950, as

amended, namely 727.01(c) and said operations do not qualify for any of the exemptions established therein.

6. The Court further finds that the said Plaintiffs have net profits within the meaning of Section 727.01(j) and the corresponding definitions in the County resolutions. Such are the same as reported for federal income tax purposes.

7. Plaintiffs are not exempted from local occupational license taxes by KRS 136.300 which imposes upon them a state tax of $1.00 per $1,000 of paid-in capital. That statute, and KRS 132.200 likewise, only exempt the Plaintiffs from local ad valorem taxes on their intangible personal property.

8. The Plaintiffs have attacked the constitutionality under the State Constitution of the occupational license taxes. On this issue, the Court is bound by prior decisions of the Court of Appeals expressly upholding the constitutionality of the City occupational license tax, the County occupational license tax and the occupational license tax for schools and accordingly, finds the occupational license taxes to be constitutional.

9. The Plaintiffs are not exempt from the City occupational license tax under the exemption which appears in KRS 91.200 and 92.281 for companies which pay both an ad valorem tax and a franchise tax. The Court finds that this exemption is applicable only to public service corporations and is meant to accord with the specific exemption for public service corporations found in the statutes authorizing the other occupational license taxes.

10. The court has found that the Defendants are not discriminating against federally chartered savings and loan associations such as the Plaintiffs in favor of state chartered savings and loan associations. State chartered savings and loan associations are the only other "similar or local mutual cooperative thrift and home financing institutions" operating in Louisville and Jefferson County. So



Section 5(h) of the Homeowners' Loan Act of 1933 [12 U.S.C. §1464(h)] is not being violated.

11. The failure of the Defendants to attempt the collection of occupational license taxes from banks, credit unions, mutual savings banks, banks for cooperatives, and production credit associations, while at the same time seeking to collect taxes from these Plaintiffs, does not constitute a violation of equal protection under the Fourteenth Amendment nor a violation of the uniformity requirement for taxation under Section 171 of the Kentucky State Constitution. As a finding of fact the Court found significant differences between the Plaintiffs and the above listed organizations. The power of state and local legislative bodies to classify businesses based upon the difference in operation or characteristics clearly exists and has been approved by the highest courts of this state and nation. Certain of the above listed organizations additionally are either exempt by statute, have no net income for federal income tax purposes and so have no net profits for City license tax purposes, or certain of them do not exist within the City or County.

12. The Plaintiffs are not entitled to deduct interest earned on federal obligations while establishing their income for purposes of occupational license tax liability. Title 31 U.S.C. §742 exempts such interest from taxation except that imposed by the following type of tax: "nondiscriminatory franchise or other nonproperty taxes in lieu thereof imposed on corporations." This Court finds that the occupational license taxes involved herein come within the exception to the exemption contained therein.

13. The Defendants are not estopped from requiring said Plaintiffs to include such interest in computing their total income for purposes of occupational license tax liability because of actions allegedly taken in another Jefferson Circuit Court case styled *Commissioners of the Sinking*

*Fund of the City of Louisville* v. *Republic Building and Loan Association.* Apparently, the federal interest question was not raised in that case and arguments of Plaintiffs are not sufficient to maintain estoppel or issue preclusion against a public body seeking to perform a governmental function.

## JUDGMENT

In accordance with the foregoing Findings of Fact and Conclusions of Law and on motion of the Defendants, the Court hereby grants the Defendants Summary Judgment pursuant to Rule 56 of the Kentucky Rules of Civil Procedure and enters the following Order and Declaration of Rights:

1. The Plaintiffs are subject to and obligated to pay the City and County occupational license taxes, the occupational license tax for schools and the occupational license tax for the Transit Authority for River City. The Plaintiffs do not qualify under any existing exemption from these taxes.

2. The net profits of the Plaintiffs for purposes of computing their occupational license tax liability shall be the same as reported to the Internal Revenue Service for federal corporate income tax purposes subject to the few adjustments provided for in the Louisville ordinances and Jefferson County resolutions and orders.

3. The Plaintiffs are not entitled to deduct interest earned on federal obligations in establishing income for purposes of computing their occupational license tax liability.

4. The Plaintiffs therefore are required to register with the Sinking Fund and file occupational license tax returns for the tax years involved and henceforward.

5. The Sinking Fund shall have the right to recover from the Plaintiffs the occupational license taxes due from them for the past five years or for such longer period of



time as to which the parties may have agreed by appropriate waivers to extend the period of limitations plus the interest and penalties provided for in Section 727.32 of the Louisville ordinances and the corresponding provisions in the Jefferson County resolutions and orders.

6. The Plaintiffs shall bear the costs of this action.

Entered this 12th day of November, 1975.

(s) James A. Hubbs, Circuit Judge

## APPENDIX E

# COURT OF APPEALS OF KENTUCKY

**File No. CA-219-MR**

AVERY FEDERAL SAVINGS AND LOAN ASSOCIATION, ET AL. - - - *Appellants*

*v.*

WILLIAM D. MEYERS, ET AL. - - - - *Appellees*

AND: **No. CA-348-MR**

FIRESIDE GREATER KENTUCKY SAVINGS AND LOAN ASSOCIATION - - - - - - *Appellant*

*v.*

WILLIAM D. MEYERS, ET AL. - - - - *Appellees*

AND: **No. CA-349-MR**

SOUTHERN FEDERAL SAVINGS AND LOAN ASSOCIATION - - - - - - *Appellant*

*v.*

WILLIAM D. MEYERS, ET AL. - - - - *Appellees*

**ORDER DENYING PETITIONS FOR REHEARING—**
Entered: February 24, 1978

BEFORE: VANCE, WILHOIT and WINTERSHEIMER, Judges.

The Court having fully considered the Petitions for Rehearing and the Responses thereto filed in CA-219-MR, and being sufficiently advised, it is ORDERED that the same are hereby DENIED.

(s) Donald C. Wintersheimer
Judge, Court of Appeals



## APPENDIX F

# SUPREME COURT OF KENTUCKY

**78-SC-114-D**
**(CA-219-MR, CA-348-MR, and CA-349-MR)**

AVERY FEDERAL SAVINGS AND LOAN ASSOCIATION ET AL. - - - - *Movants*

*v.*

WILLIAM D. MEYERS ET AL. - - - *Respondents*

*Jefferson Circuit Court*
*192965*

**ORDER DENYING DISCRETIONARY REVIEW—**
Entered June 6, 1978

The motion of Avery Federal Savings and Loan Association, et al., for a review of the decision of the Court of Appeals is denied, and the decision stands affirmed.

Sternberg, J., not sitting.

(s) John S. Palmore
Chief Justice

## APPENDIX G

# COURT OF APPEALS OF KENTUCKY

**OPINION RENDERED: NOVEMBER 25, 1977**

---

AVERY FEDERAL SAVINGS AND LOAN ASSOCIATION, ET AL.

*v.*

WILLIAM D. MEYERS, ET AL.

**File No. CA-219-MR**

---

*Appeal from Jefferson Circuit Court*
*Action No. 192965*

---

**MANDATE**—Issued June 29, 1978

The Court being sufficiently advised, it seems the judgment herein is erroneous.

It is therefore considered that said judgment be reversed for proceedings consistent with the opinion herein; which is ordered to be certified to said court.

It is further considered that the appellant recover of the appellee its cost herein expended.

February 24, 1978—Appellant's and Appellee's Petition for Rehearing Denied.

June 6, 1978—Movant's (Avery) Motion for Discretionary Review Denied by Supreme Court.

June 27, 1978—Movant's (Meyers) Motion for Discretionary Review Denied by Supreme Court.

(s) John C. Scott, Clerk



## APPENDIX H

# COURT OF APPEALS OF KENTUCKY

**CA-219-MR**

---

AVERY FEDERAL SAVINGS AND LOAN ASSOCIATION, ET AL. - - - *Appellants*

*v.*

WILLIAM D. MEYERS, ET AL. - - - - *Appellees*

---

**NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES**—Filed July 7, 1978

Notice is hereby given that Avery Federal Savings and Loan Association, Colonial Federal Savings and Loan Association, Equitable Federal Savings and Loan Association, Greater Louisville First Federal Savings and Loan Association, Jefferson Federal Savings and Loan Association, Lincoln Federal Savings and Loan Association, Louisville Home Federal Savings and Loan Association, Portland Federal Savings and Loan Association, and South East Federal Savings and Loan Association, appellants in the above captioned case, hereby appeal to the Supreme Court of the United States from as much of the final judgment (mandate) of the Court of Appeals of Kentucky, entered in this action on June 29, 1978, as holds that appellants are liable to tax upon the interest received by them from United States securities.

This appeal is taken pursuant to U.S.C., Tit. 28, §1257(2).

(s) Gerald Kirven

Gerald Kirven
501 South Second Street
Louisville, Kentucky 40202
Attorney for Appellants

Form OL-3

# OCCUPATIONAL LICENSE RETURN 19___

## City of Louisville; Jefferson County, Kentucky; Mass Transit; School Boards

Print Name & Address →

Change If Incorrect

For Year Ended ___ ___ ___ (Month Day Year)

Account Number

IND. CODE

## PART I – All Licensees Must Answer The Questions Below

A. What is your Social Security Number (if any)?_____
Your Federal Tax Identification Number (if any)?_____

B. What is your Principal Business Activity? _____

C. During the past year, did Federal Authorities change or propose to change net income as reported for that year or any prior year?_____
(If yes, attach statement of changes.)

D. Do you have more than one place of business in Jefferson County (including Louisville)?_____
(If yes, you must complete Schedule 1 on reverse side.)

E. Was there a change in ownership, or did you cease doing business during the past year?_____(If yes, complete Schedule 2, reverse side.)

F. Did you file a corporate consolidated Federal return?_____
Did you file a corporate consolidated Kentucky return?_____

## PART II – Complete Only The Section Which Applies To You

### SECTION A – To Be Completed By Individuals Only

| | |
|---|---|
| 1. Gross Employee Compensation (salary, etc.) earned in Jefferson County (including Louisville) from which no occupational fees were withheld. Enter here and in appropriate column(s) on Line 4 of Part III | $ |
| 2. Gross Receipts per Federal Schedule C and/or Schedule F | |
| 3. Total Business Expenses (Deductions per Federal Schedule C and/or Schedule F) | |
| 4. Business Net Profits (Line 2 minus Line 3) | |
| 5. Enter Net Adjustment from Schedule 3 (reverse side of this form) | |
| 6. Adjusted Net Profit (Line 4 plus Line 5). Enter here and in Part III, Line 1 | $ |

### SECTION B – To Be Completed By Partnerships and Corporations

| | |
|---|---|
| 1. Total Income per Federal Form 1065, 1120, 1120S, 1120L or 1120M, as applicable | $ |
| 2. Total Deductions per Federal Form 1065, 1120, 1120S, 1120L or 1120M, as applicable | |
| 3. Enter total on Line 1, above, less total on Line 2 | |
| 4. Enter any adjustments from Schedule 3, reverse side of this form | |
| 5. Adjusted Net Profit (Line 3 plus Line 4). Enter here and in Part III, Line 1 | $ |

## PART III – All Licensees Must Complete This Part

1. Enter Adjusted Net Profit from either Section A (Line 6) or Section B (Line 5), as applicable. $

— READ INSTRUCTIONS BEFORE COMPLETING LINES 2 THROUGH 12 —

| | LOUISVILLE Computation (COLUMN A) | JEFFERSON CO. Computation (COLUMN B) | MASS TRANSIT Computation (COLUMN C) | SCHOOL BOARDS Computation (COLUMN D) |
|---|---|---|---|---|
| 2. Percentage (see Instructions) | % | % | Enter on Line 3 Below sum of Louisville and Jefferson County net profits | Enter on Line 3 Below sum of Louisville and Jefferson County net profits |
| 3. Net Profits Allocation (Line 1 X Line 2) | $ | $ | $ | $ |
| 4. Enter employee compensation (see Instructions) | | - | Not Applicable | |
| 5. Enter totals of amounts on Lines 3 and 4 (but no less than Line 4) | | | Prior To 1-1-75 | |
| 6. Occupational License Fees (see Instructions for Col. C rate) | at 1¼% $ | at 1¼% $ | at % $ | at ¼% $ |
| 7. Total Fees Due (Sum of Columns A, B, C and D, Line 6) | | | | $ |
| 8. Enter "Initial Fee," if any (see Instructions) | | | $ | |
| 9. Enter any credit due from prior years | | | $ | |
| 10. Enter total of Lines 8 and 9 (but no more than Line 7) | | | | $ |
| 11. Balance Fees Due (Line 7 less Line 10) | | | | $ |
| 12. Penalty and Interest (see Instructions) | | | | $ |
| 13. Amount to be paid (Line 11 plus Line 12) | | | | $ |

**RETURN MUST BE SIGNED** →

I hereby certify that the statements made herein and in any supporting schedules are true, correct, and complete to the best of my knowledge.

Signature of Individual Preparing Return _____ Date ___/___/___

Signature of Licensee _____ Date ___/___/___

MAKE CHECKS PAYABLE AND MAIL TO: COMMISSIONERS OF THE SINKING FUND
617 W. JEFFERSON ST. – LOUISVILLE, KENTUCKY 40202

## SCHEDULE 1
### BUSINESS LOCATIONS IN LOUISVILLE AND JEFFERSON COUNTY

To be completed by all licensees with more than one business location in Louisville and Jefferson County, and by licensees whose mailing addresses are not their local business addresses. List below all business locations and indicate whether or not the profit from the operation at each location listed is included in this return. If profit is not included, give account number under which operation is filed.

| NAME | STREET ADDRESS | PROFIT INCLUDED | | ACCT NUMBER |
|---|---|---|---|---|
| | | YES | NO | |
| | | YES | NO | |
| | | YES | NO | |
| | | YES | NO | |
| | | YES | NO | |

## SCHEDULE 2
### CHANGE IN OWNERSHIP OR ACTIVITY

To be completed by each licensee who ceased doing business or whose business changed ownership during the past year.

A. Date ceased doing business ___/___/___

B. Date of change of ownership ___/___/___

C. If the ownership changed, give the name and address of new owner _____

_____

D. Other pertinent information _____

_____

## SCHEDULE 3
### Adjustment of Federal Tax Base to Occupational License Fee Base

[The alcoholic beverage net profits deduction (see Instructions as to Schedule 3) is applicable to individuals, partnerships and corporations. An individual licensee, however, should make no other entries in this Schedule except as to specific items (and amounts) which are included in his Federal Schedule C and/or F for the same period.]

**DEDUCTIONS ALLOWABLE ON FEDERAL RETURN BUT NOT ON THIS RETURN**

A. State or Local Taxes Based on Income .... $ _____

B. Occupational License Fees ..... _____

C. Partners' Salaries (attach Schedule) ..... _____

D. Other Items (attach Statement) ..... _____

E. Total Additions ..... $ _____

**ITEMS SUBJECT TO FEDERAL TAX BUT EXEMPT FROM OCCUPATIONAL TAX**

F. Profit from Sale of Alcoholic Beverages (see Instr.) ..... $ _____

G. Interest on U.S. Govt' Obligations ..... _____

H. Other Items (attach Statement) ..... _____

I. Total Deductions ..... $ _____

NET ADJUSTMENT (Line E minus Line I). Enter here and in Part II (Line 5, Section A, or Line 4, Section B) ..... $ _____

## SCHEDULE 4
### COMPUTATION OF ALLOCATION PERCENTAGES

The allocation formula is for the use of licensees whose business activity is not confined to either the City of Louisville or to Jefferson County outside Louisville. The percentage of adjusted net profit (Part III, Line 1) subject to each occupational fee is obtained by computing the average of (1) the percentage of receipts from sales made and/or services performed within each local licensing jurisdiction to the total of such receipts everywhere, and (2) the percentage of payroll in each local jurisdiction to payroll everywhere. The figures which you insert in Columns A, B, and C may be rounded to the nearest dollar.

| Allocation Factors | Column A City of Louisville | Column B Jefferson County Outside Louisville | Column C Everywhere | Column D A ÷ C = D Louisville % | Column E B ÷ C = E Jeff. Co. % |
|---|---|---|---|---|---|
| 1. GROSS RECEIPTS from sales made and/or services rendered | $ | $ | $ | % | % |
| 2. (a) Total wages, salaries, and other compensation of all employees | | | | | |
| (b) LESS: Compensation of executive officers if applicable (see instructions) | | | | | |
| TOTAL NET WAGES FACTOR | $ | $ | $ | % | % |
| 3. TOTAL PERCENTAGES (add the percentages computed on lines 1 and 2 of Columns D and E, respectively) | | | | % | % |
| 4. AVERAGE PERCENTAGE (Line 3 divided by number of percentages used for each column) | | | | % | % |
| | | | | Enter this % on Part III, Line 2, Col. A Front Page | Enter this % on Part III, Line 2, Col. B Front Page |

Supreme Court, U. S.
FILED
SEP 10 1978
MICHAEL RODAK, JR., CLERK

# SUPREME COURT OF THE UNITED STATES

October Term, 1978

No. 78-293

---

**AVERY FEDERAL SAVINGS AND LOAN ASSOCIATION, et al.** - - - - - **Appellants**

*versus*

**WILLIAM D. MEYERS, et al., Commissioners of the Sinking Fund of the City of Louisville** - - - - - - - - - **Appellees**

---

**On Appeal From the Court of Appeals of Kentucky**

---

## MOTION OF APPELLEES TO DISMISS APPEAL

---

**ROBERT F. MATTHEWS**
**JOHN H. STITES, III**
**GREENEBAUM, DOLL & McDONALD**
3300 First National Tower
Louisville, Kentucky 40202

*Attorneys for Appellees*

WESTERFIELD-BONTE CO., 619 W. KENTUCKY—P.O. BOX 3251, LOUISVILLE, KY.

## INDEX AND TABLE OF AUTHORITIES


| | PAGE |
|---|---|
| **Motion of Appellees to Dismiss Appeal** | 1 |
| **Counterstatement of Question Presented** | 1 |
| **Counterstatement of Case** | 2, 3 |
| Ky. Rev. Stat. 91.130 | 2 |
| Ky. Rev. Stat. 91.200 | 2 |
| Kentucky Constitution §181 | 2 |
| 31 U.S.C. §742 | 1– 3 |
| **Federal Question Not Substantial** | 3– 9 |
| Louisville Codified General Ordinances §727.02 | 3– 4 |
| Louisville Codified General Ordinances §727.01 | 4 |
| *Howard* v. *Commissioners of the Sinking Fund of the City of Louisville*, 344 U. S. 624 (1953) | 4 |
| Buck Act (4 U.S.C. §105 et seq.) | 4 |
| 31 U.S.C. §742 | passim |
| *Tradesmens National Bank* v. *Oklahoma Tax Comm.*, 309 U. S. 560 (1940) | 5, 8 |
| Home Owners' Loan Act of 1933 (12 U.S.C. §1461 et seq.) | 6 |
| *Society for Savings* v. *Coite*, 73 U. S. (6 Wall.) 594 (1868) | 6, 8 |
| *Provident Institution for Savings* v. *Massachusetts*, 73 U. S. (6 Wall.) 611 (1868) | 6– 8 |
| *Home Insurance Co.* v. *New York*, 134 U. S. 594 (1890) | 7, 8 |
| *Educational Films Corp.* v. *Ward*, 282 U. S. 379, 71 A.L.R. 1226 (1931) | 7, 8 |
| *Flint* v. *Stone Tracy Co.*, 220 U. S. 107 (1911) | 7, 8 |
| *Werner Machine Co.* v. *Director of Div. of Taxation*, 350 U. S. 492 (1956) | 8– 9 |
| *Pacific Co.* v. *Johnson*, 285 U. S. 480 (1932) | 9 |
| *Reuben L. Anderson-Cherne, Inc.* v. *Comm'r of Taxation*, 303 Minn. 124, 226 N. W. 2d 611, app. dism'd 423 U. S. 886 (1975) | 9 |

# SUPREME COURT OF THE UNITED STATES

**October Term, 1978**

**No. 78-293**

---

AVERY FEDERAL SAVINGS AND LOAN ASSOCIATION, ET AL. - - - *Appellants*

*v.*

WILLIAM D. MEYERS, ET AL., Commissioners of the Sinking Fund of the City of Louisville - - - *Appellees*

---

ON APPEAL FROM THE COURT OF APPEALS OF KENTUCKY

---

## MOTION OF APPELLEES TO DISMISS APPEAL

---

In accordance with Rule 16(1)(b) of the Rules of the Court, the Appellees hereby move the Court to dismiss this appeal on the ground that this appeal manifestly does not present a substantial Federal question warranting argument or further consideration.

## COUNTERSTATEMENT OF QUESTION PRESENTED

May state and local governments under 31 U.S.C. §742 (R.S. §3701) and the prior decisions of this Court deny corporations a deduction for interest earned on Federal bonds and obligations in computing their liability for a privilege or franchise tax measured by net income?

## COUNTERSTATEMENT OF CASE

The City of Louisville and Jefferson County, in which Louisville is located, both levy a general occupational license tax. Additionally, a third general occupational license tax is levied by the County for the benefit of local schools. The Appellees, as the individual members of the Commissioners of the Sinking Fund of the City of Louisville, a public corporate body existing under §91.130 of the Kentucky Revised Statutes ("KRS"), collect all three of these taxes. Inasmuch as the County and school taxes closely resemble the City tax, upon which they were modelled, the Appellees will, as the Appellants have done, limit their discussion to the City tax.

The City tax is authorized by KRS 91.200 and §181 of the Kentucky Constitution and is levied pursuant to ordinances consolidated in Chapter 727 of the Codified General Ordinances of Louisville. As more fully discussed hereafter, the tax is measured by a small flat percentage of the gross compensation of salaried workers and wage earners and of the net income of businesses and self-employed persons.

The Appellants are all savings and loan associations, which have always claimed to be wholly exempt from the general occupational license taxes. In 1974 suit was brought to test this claim. Early in the proceedings, 31 U.S.C. §742 and the case law related thereto came to the attention of the Appellees and they indicated their intent, in the event the Appellants were not found wholly exempt from license taxes, to deny them,



and all other corporations thereafter, a deduction for interest on Federal bonds and obligations in computing their license tax liability. The issue was thereupon joined between the Appellants and Appellees. (Previously, the Appellees had mistakenly believed that Federal law mandated a deduction for interest on Federal obligations and so had allowed all taxpayers such a deduction although no provision of the Louisville ordinances or Kentucky statutes authorized one.)

The courts below found the Appellants to be subject to the general occupational license taxes. Additionally, it was decided that the Appellees could deny the Appellants a deduction for interest on Federal bonds and obligations in computing their license tax liability under the provisions of 31 U.S.C. §742 and the decisions of this Court relative to the subject.

## FEDERAL QUESTION NOT SUBSTANTIAL

The crux of this case is obviously the nature and incidence of the occupational license taxes. In this regard, §727.02(a) of the Louisville Ordinances, under which the City tax is imposed, provides as follows:

> "On and after January 1, 1959, every person, association, corporation or other entity engaged in any occupation, business, trade, profession or other activity in the City shall pay into the Sinking Fund an annual license fee for the privilege of engaging in said activities, which license fee shall be measured by one and one-fourth (1¼%) percent of (a) all salaries, wages, commissions and other compensation earned by every person in the City for work done or services performed or ren-

dered in the City; and (b) the net profits of all businesses, professions or occupations from activities conducted in the City."

A person's net profit for purpose of the City license tax is defined by §727.01(j) of the Ordinances to be essentially his net income for Federal income tax purposes (see Appendix B to Jurisdictional Statement).

From the foregoing, it is manifest that the Louisville general occupational license tax is a privilege tax measured by either gross compensation or net income depending upon the taxpayer. With regard to corporate taxpayers, to which this appeal relates exclusively, the City tax is imposed for the privilege of transacting business and the exercising of their corporate franchises in Louisville.

The nature of the City occupational license tax has been previously considered by this Court in *Howard* v. *Commissioners of the Sinking Fund of the City of Louisville,* 344 U. S. 624 (1953), a case concerning whether the imposition of the City tax on Federal employees was authorized by the Buck Act (4 U.S.C. §105 et seq.). A majority of the Court held that while the City tax was categorized as a privilege tax, it came within the special definition of an income tax for purposes of the Buck Act. Under 4 U.S.C. §110(c) an "income tax" for purposes of the Act is defined as "any tax levied on, with respect to, or measured by, net income, gross income or gross receipts." Accordingly, the Court found that the Buck Act authorized Louisville to collect occupational license taxes from Federal employees working in the City. Two members of the



Court, however, Justice Douglas and Justice Black, dissented. In their opinion, the City tax was, as the Kentucky courts had found, a privilege tax and was too dissimilar from an income tax to qualify even under the broad definition of the Buck Act.

The general exemption of Federal bonds and obligations, and the interest thereon, from state and local taxation is set forth in 31 U.S.C. §742 (R.S. §3701) (Appendix C to Jurisdictional Statement). In 1959, Congress amended §742 so as to include two exceptions to the rule of general immunity. Under one of these exceptions, state and local governments are now expressly authorized to levy with regard to Federal bonds and obligations, and the interest thereon, "nondiscriminatory franchise or other nonproperty taxes in lieu thereof imposed on corporations." The Appellees submit that as the two courts below found, this exception encompasses and permits the imposition of the City occupational license tax on the full net income of Appellants, including their income from Federal obligations.

To consider the specific elements of the exception, the City occupational license tax is nondiscriminatory within the criteria established by this Court in *Tradesmens Nat. Bank* v. *Oklahoma Tax Comm.,* 309 U. S. 560 (1940), in that the tax is imposed upon the entire net income of taxpayers without regard to its source and there is no distinction between income from Federal bonds and obligations and income otherwise derived. The interest from Federal obligations is included in income for City license tax purposes not by any

special provision of the Louisville ordinances but only by their general language.

The Appellants are all Federal savings and loan associations chartered under the Home Owners' Loan Act of 1933 (12 U.S.C. §1461 et seq.) and do not deny that they are corporations. Accordingly, this case devolves into a consideration of whether the City and other two occupational license taxes at issue here may be categorized as "franchise or other nonproperty taxes in lieu thereof."

The Appellants argue strenuously that because the occupational license taxes are measured by income, they are *ipso facto* income taxes and therefore not within the ambit of 31 U.S.C. §742. A long line of decisions of this Court, however, stretching back into the 19th century has rejected this simplistic proposition. In these cases, the Court has upheld franchise and privilege taxes measured either by assets or income imposed on corporations and requiring the inclusion of Federal bonds and obligations, or the interest from same, in the computation of the amount of tax due. The 1959 amendment to 31 U.S.C. §742 to include an exception for these taxes did no more than give statutory recognition to the rule long established by this Court. The Appellees submit that the amendment must have been intended to cover taxes measured by assets or income since there is no need for such an exception with regard to franchise taxes imposed at a flat rate or otherwise measured.

As far back as 1868, this Court in *Society for Savings* v. *Coite,* 73 U. S. (6 Wall.) 594, and *Provident*



*Institution for Savings* v. *Massachusetts,* 73 U. S. (6 Wall.) 611, sustained the validity of state franchise or privilege taxes imposed on mutual savings institutions much like the Appellants herein and measured by a percentage of their deposits, or gross assets, including the portion invested in Federal bonds and obligations. See also *Home Ins. Co.* v. *New York,* 134 U. S. 594 (1890).

In *Educational Films Corp.* v. *Ward,* 282 U. S. 379, 71 A.L.R. 1226 (1931), the Court upheld the validity, against essentially the same challenge raised by the Appellants here, of a New York franchise tax measured by net income. While noting the Court's many decisions prohibiting the direct taxation by state and local governments, on the one hand, and the Federal government on the other, of each other's obligations, Justice Stone for the majority continued:

> [This Court] has held with like consistency that the privilege of exercising the corporate franchise is no less an appropriate object of taxation by one government merely because the corporate property or net income, which is made the measure of the tax, may chance to include the obligations of the other, or the income derived from them. The constitutional power of one government to reach this permissible object of taxation may not be curtailed because of the indirect effect which the tax may have upon the other. 282 U. S. at 389.

In reaching the decision above, the Court relied in part on *Flint* v. *Stone Tracy Co.,* 220 U. S. 107 (1911), in which the Court, confronted with the reverse situation, upheld the validity of a Federal franchise tax on

corporations measured by net income, including interest on state and local bonds and obligations not directly subject to Federal tax.

In both *Educational Films Corp.* and *Flint, supra,* the Court recognized that a franchise or privilege tax measured by income differs from an income tax in that to be liable for a tax of the former type, one must actually transact business and when business ceases, so does liability for the tax. The Louisville license tax is a franchise tax in this regard in that to be liable one must expressly be "engaged in . . . business . . . or other activity in the City" and when such activity stops, so does the tax.

By 1940, the Court could state in *Tradesmens Nat. Bank* v. *Oklahoma Tax Comm.,* 309 U. S. 560, 564-65, that:

> "The power of a state to levy a tax on a legitimate subject, such as a franchise, measured by net assets or net income including tax-exempt federal instrumentalities or their income is . . . well settled. *Society for Savings* v. *Coite* . . . *Provident Inst.* v. *Massachusetts* . . . *Home Ins. Co.* v. *New York* . . . *Educational Films Corp.* v. *Ward.* . . . The rule that a tax upon a legitimate subject, measured by net income, including that from tax-immune federal instrumentalities, is not an infringement of the immunity, was affirmed in *Flint* v. *Stone Tracy Co.* . . . and followed in *Educational Films Corp.* v. *Ward.*..."

Other decisions of the Court reiterating the same principles relative to this appeal as the cases cited above include *Werner Machine Co.* v. *Director of Div.*



*of Taxation,* 350 U. S. 492 (1956), and *Pacific Co.* v. *Johnson,* 285 U. S. 480 (1932).

As a tax levied on corporations for the privilege of engaging in business and exercising their corporate franchise in Louisville, the City license tax, and the other two occupational license taxes at issue here, come precisely under the exception to the general rule of state and local tax immunity of federal obligations long ago established by this Court and now contained in 31 U.S.C. §742. No Federal question not already well settled is presented by this appeal and there is no need for the Court to hear argument or consider this case further.

The same issues presented by this appeal were before the court as recently as 1975 in the appeal taken to this Court from the decision in *Reuben L. Anderson-Cherne, Inc.* v. *Comm'r of Taxation,* 303 Minn. 124, 226 N. W. 2d 611 (1975). Relying on 31 U.S.C. §742 and the decisions of this Court, the Minnesota Supreme Court in that case upheld a Minnesota corporate franchise tax measured by net income, including interest from Federal bonds and obligations. This Court dismissed the appeal for want of a substantial Federal question. 423 U. S. 886. The Appellees submit that the same action should now be taken with respect to this appeal and have so moved the Court.

Respectfully submitted,

ROBERT F. MATTHEWS
JOHN H. STITES, III
GREENEBAUM, DOLL & MCDONALD
3300 First National Tower
Louisville, Kentucky 40202

*Attorneys for Appellees*

Supreme Court, U. S.
FILED
SEP 22 1978
JR., CLERK

# SUPREME COURT OF THE UNITED STATES

October Term, 1978

No. 78-293

---

**AVERY FEDERAL SAVINGS AND LOAN ASSOCIATION, et al.** - - - - - **Appellants**

*versus*

**WILLIAM D. MEYERS, et al., Commissioners of the Sinking Fund of the City of Louisville** - - - - - - - - - **Appellees**

---

**On Appeal From the Court of Appeals of Kentucky**

---

## APPELLANTS' BRIEF OPPOSING MOTION TO DISMISS APPEAL

---

**GERALD KIRVEN**
**BROOKS ALEXANDER**
**MIDDLETON, REUTLINGER & BAIRD**
501 South Second Street
Louisville, Kentucky 40202
*Attorneys for the Appellants*

WESTERFIELD-BONTE CO., 619 W. KENTUCKY—P.O. BOX 3251, LOUISVILLE, KY.

## TABLE OF CONTENTS


| | PAGE |
|---|---|
| Appellants' Brief Opposing Motion to Dismiss Appeal | 1– 6 |
| Conclusion | 6– 7 |
| Appendix J | 9–12 |
| Appendix K | 13–14 |
| Appendix L | 15–16 |

## TABLE OF AUTHORITIES CITED


**Cases:** PAGE

*Educational Films Corp.* v. *Ward*, 282 U. S. 379 (1931) ..... 2, 6

*Flint* v. *Stone Tracy Co.*, 220 U. S. 107 (1911) .....2–3, 4

*Home Insurance Co.* v. *New York*, 134 U. S. 594 (1890) ..... 2

*Pacific Co.* v. *Johnson*, 285 U. S. 480 (1932) ..... 2

*Provident Institution* v. *Massachusetts*, 6 Wall. (73 U. S.) 611 (1868) ..... 2, 3

*Reuben L. Anderson-Cherne, Inc.* v. *Comm'r of Taxation*, 303 Minn. 124, 226 N. W. 2d 611, app. dism'd 423 U. S. 886 (1975) ..... 2

*Society for Savings* v. *Coite*, 6 Wall. (73 U. S.) 594 (1868) ..... 2, 3

*Tradesmens Bank* v. *Tax Comm'n.*, 309 U. S. 560 (1940) ..... 2

*Werner Co.* v. *Director of Taxation*, 350 U. S. 492 (1956) ..... 2, 3

**Constitutional Provisions, Statutes and Ordinances:**

31 U.S.C. §742 (R.S. §3701) .....1, 5, 6

Kentucky Revised Statutes:

§136.070 ..... 3, 4

§136.290 ..... 4

§136.300 ..... 4

**General Ordinances of the City of Louisville:**

§727.02 ..... 4

§727.05 ..... 6

§727.06 ..... 6

**Miscellaneous:**

Legislative History of 31 U.S.C. §742 ..... 5, 6


# SUPREME COURT OF THE UNITED STATES

**October Term, 1978**

**No. 78-293**

AVERY FEDERAL SAVINGS AND LOAN ASSOCIATION, ET AL. - - - *Appellants*

*v.*

WILLIAM D. MEYERS, ET AL., Commissioners of the Sinking Fund of the City of Louisville - - - *Appellees*

ON APPEAL FROM THE COURT OF APPEALS OF KENTUCKY

## APPELLANTS' BRIEF OPPOSING MOTION TO DISMISS APPEAL

The vices of the Sinking Fund's "Counterstatement of Question Presented" are that it tracks the language of 31 U.S.C. §742 (R.S. §3701) and asks an abstract question. It avoids the relevant, concrete question which is, Is the tax in issue the kind of tax contemplated by the words "nondiscriminatory franchise . . . taxes . . . imposed on corporations"? The answer to this concrete question is "no" for the following reasons.

Before the 1959 amendment to 31 U.S.C. §742, many of this Court's decisions, some of which the Sinking Fund cites, approved taxes where federal, state or local

obligations were part of the measure of the tax. Cases cited by the Sinking Fund involved four categories of franchise taxes imposed upon corporations:

(a) by states and measured by net assets or net worth, *Society for Savings, Provident Institution* and *Werner Machine Co.;*

(b) by states and measured by net income, *Tradesmens, Educational Films, Pacific Co.,* and *Reuben L. Anderson;*

(c) by a state and measured by dividends paid or value of capital stock, *Home Insurance;* and

(d) by the federal government and measured by net income, *Stone Tracy.*

The common elements of all of the taxes approved in the foregoing decisions are that (1) the levies were exclusively upon corporations, (2) they were nondiscriminatory as to federal, state or local obligations in that such obligations were treated the same as any other assets or income of the corporation, and (3) the thing taxed was the privilege of doing business in corporate form.

Mr. Justice Day, speaking for the Court in *Flint* v. *Stone Tracy Co.,* 220 U. S. 107, 161-2 (1911), explained the true incidence of the corporate excise tax approved there and in the other foregoing cases:

> "In the case at bar we have already discussed the limitations which the Constitution imposes upon the right to levy excise taxes, and it could not be said, even if the principles of the Fourteenth Amendment were applicable to the present case, that there is no substantial difference between the carrying on of business by the corporations taxed, and the same business when conducted by a private firm or individual. The thing taxed is not the mere dealing in merchandise, in which the actual transactions may be the same, whether conducted by individuals or corporations, but the tax is laid upon the privileges which exist in conducting business with the advantages which inhere in the corporate capacity of those taxed, and which are not enjoyed by private firms or individuals. These advantages are obvious, and have led to the formation of such companies in nearly all branches of trade. The continuity of the business, without interruption by death or dissolution, the transfer of property interests by the disposition of shares of stock, the advantages of business controlled and managed by corporate directors, the general absence of individual liability, these and other things inhere in the advantages of business thus conducted, which do not exist when the same business is conducted by private individuals or partnerships. It is this distinctive privilege which is the subject of taxation, not the mere buying or selling or handling of goods which may be the same, whether done by corporations or individuals."



The Commonwealth of Kentucky itself, as distinguished from Louisville and Jefferson County, has corporate taxes similar to those approved in *Society for Savings, Provident Institution,* and *Werner Machine Co.* The Kentucky corporation license tax of general application is found in Kentucky Revised Statutes (KRS) §136.070, printed in Appendix J. That statute imposes upon foreign and domestic corporations "an annual license tax of seventy cents (70¢) on each one thousand dollars ($1,000) of the capital em-

ployed in the business." Subsection (5) provides: "No corporation required to pay an annual license tax under this section shall pay less than ten dollars." Savings and loan associations are exempt from paying the foregoing tax but are subject to a similar tax imposed by KRS §§136.290 and 136.300, printed in Appendix K. As provided in these last sections, savings and loan associations pay a tax of $1 for each $1,000 on their capital stock.

In contrast to the Kentucky, state and federal corporate taxes discussed above, the tax which the Sinking Fund administers is characterized by the Sinking Fund itself as "a general occupational license tax" (Motion, pages 2, 3, and 4). The word "general" is indeed correct. Far from being a tax upon corporate franchises, this is a tax levied upon "every person, association, corporation or other entity engaged in any occupation, business, trade, profession or other activity in the City . . . for the privilege of engaging in said activities" (§727.02(a)) (Jurisdictional Statement, Appendix B). For all save employed, natural persons, the tax is upon net profits. Unlike the tax imposed by KRS 136.070 (5), there is no minimum tax of $10 or any other sum.

The words of Mr. Justice Day in *Stone Tracy* quoted above are particularly apt in that the city tax is imposed upon business activities "in which the actual transactions may be the same, whether conducted by individuals or corporations." The thing taxed is not the privilege of doing business in corporate form.

The Commonwealth has granted domestic corporations their franchises and, as seen above, has enacted



corporation license taxes. The Sinking Fund, on its own, has attempted to make a corporate franchise tax out of the Louisville tax by singling out the corporate taxpayers, ignoring the fact that the tax falls alike upon "every person, association, corporation or other entity," and declaring, without benefit of any statute or ordinance, that as to corporations, the "tax is imposed for . . . the exercising of their corporate franchises in Louisville" (Motion, page 4). The Sinking Fund says "this appeal relates exclusively" to corporate taxpayers (*Ibid.*), but the tax itself is not imposed exclusively upon corporate taxpayers.

The associations quoted the legislative history of the 1959 amendment to 31 U.S.C. §742 (Jurisdictional Statement, page 10). The Sinking Fund agrees that one purpose of the amendment was to codify past decisions of this Court creating exceptions to the general prohibition against any kind of state taxation on federal obligations (Motion, page 6). The Sinking Fund, however, ignores another important purpose, which, the history states, was to "prohibit a State from including interest on Federal obligations in computing 'gross income' upon which taxable net income is determined." In short, that aim was to prevent state and local governments from subjecting federal obligations to income taxation.

The associations have already demonstrated that the tax is an income tax by the way it operates (Jurisdictional Statement, pages 11-16). The Sinking Fund failed to challenge the demonstration and says that the associations rely only upon the "simplistic proposi-

tion" that the tax is an income tax only because it is "measured by income" (Motion, page 6). The Sinking Fund likens this tax to the one approved in *Educational Films,* saying, "when business ceases, so does liability for the tax" (Motion, page 8). In *Educational Films,* the past year's profits measured the tax to be paid in advance for doing business in the corporate form during the coming year. Not so with the Louisville tax. No tax is paid in advance but only after the year's end and, not then, unless there are net profits. (General Ordinances of the City of Louisville, §§727.05 and 727.06, printed in Appendix L.) The associations invite the Court's careful study of the analysis of the tax made at the cited pages of the Jurisdictional Statement to understand the tax as an income tax. "[T]he nature of a tax must be determined by its operation rather than by particular descriptive language which may have been applied to it." *Educational Films Corp.* v. *Ward,* 282 U. S. 379, 387 (1931). As an income tax, the Louisville tax is not within any exception to 31 U.S.C. §742.

## CONCLUSION

This Court has never allowed a tax such as this one. This Court has never permitted states or localities to include interest on federal obligations in the measure of an income tax or of any franchise tax other than one on the privilege of existing as a corporation.

The 1959 amendment to 31 U.S.C. §742 prohibits this tax as an income tax on interest on Government



obligations and it forbids its imposition under the guise of a franchise tax upon corporations, since it is not such a tax.

The Court should therefore overrule the motion to dismiss the appeal.

Respectfully submitted,

GERALD KIRVEN
BROOKS ALEXANDER
MIDDLETON, REUTLINGER & BAIRD
501 South Second Street
Louisville, Kentucky 40202
(502) 584-1135

*Attorneys for Appellants*

September 25, 1978.

# APPENDIX



## APPENDIX J

KENTUCKY REVISED STATUTES

**136.070 Corporation license tax; exemptions; apportionment**

(1) Every corporation organized under the laws of this state, every corporation having its commercial domicile in this state, and every foreign corporation owning or leasing property located in this state or having one or more individuals receiving compensation in this state, except state and national banks and trust companies, savings and loan associations organized under the laws of this state and under the laws of the United States and making loans to members only, production credit associations, insurance companies, including farmers' or other mutual hail, cyclone, windstorm or fire insurance companies, insurers and reciprocal underwriters, public service companies subject to taxation under KRS 136.120, those corporations exempted by section 501 of the Internal Revenue Code, and any other religious, educational, charitable or like corporations not organized or conducted for pecuniary profit, shall pay to the state an annual license tax of seventy cents (70¢) on each one thousand dollars ($1,000) of the capital employed in the business as computed under the provisions of subsections (2) and (3) of this section.

(2)(a) The term "capital" as used in this section means capital stock, surplus, advances by affiliated companies, intercompany accounts, borrowed monies or any other accounts representing additional capital used and employed in the business. Accounts properly defined as "capital" in this section shall be reported at the value reflected on financial statements prepared for book purposes as of the last day of the calendar or fiscal year.

(b) "Capital employed," in the case of corporations having property or payroll only in this state, means "capital" as defined above.

(c) "Capital employed," in the case of corporations having property or payroll both within and without this state means "capital" as defined above and as apportioned under subsection (3) of this section.

(d) Property means either real property or tangible personal property which is either owned or leased. Payroll means compensation, paid to one or more individuals, as described in subsection (3) of this section. Property and payroll are deemed to be entirely within this state if all other states are prohibited by Public Law 86-272, as it existed on December 31, 1975, from enforcing income tax jurisdiction.

(3) The total capital, as determined under subsection (2) of this section, shall be apportioned as follows:

(a) The total capital shall be multiplied by a fraction, the numerator of which is the property factor plus the payroll factor, plus the sales factor, and the denominator of which is three (3).

(b) The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in this state during the tax period and the denominator of which is the average value of all the taxpayer's real and tangible personal property owned or rented and used during the tax period; provided, however, that property which has been certified as a pollution control facility as defined in KRS 224.850 shall be excluded from the property factor.

1. Property owned by the taxpayer is valued at its original cost. If the original cost of any property is not determinable or is nominal or zero such property shall be valued by the department under regulations promulgated by the department. Property rented by the taxpayer is valued at eight (8) times the net annual rental rate. Net



annual rental rate is the annual rental rate paid by the taxpayer less any annual rental rate received by the taxpayer from subrentals, provided that such rental and such subrentals are reasonable. If the department determines that the annual rental or subrental rate is unreasonable, or if nominal or zero rate is charged, the department may determine and apply such rental rate as will reasonably reflect the value of the property rented by the taxpayer.

2. The average value of property shall be determined by averaging the values at the beginning and ending of the tax period but the department may require the averaging of monthly values during the tax period if reasonably required to reflect properly the average value of the taxpayer's property.

(c) The payroll factor is a fraction, the numerator of which is the total amount paid or payable in this state during the tax period by the taxpayer for compensation, and the denominator of which is the total compensation paid or payable everywhere during the tax period. Compensation is paid or payable in this state if:

1. The individual's service is performed entirely within the state; or

2. The individual's service is performed both within and without the state, but the service performed without the state is incidental to the individual's service within the state; or

3. Some of the service is performed in the state and the base of operation or, if there is no base of operations, the place from which the service is directed or controlled is in the state, or the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the individual's residence is in this state.

(d) The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the tax period, and the denominator of which is the total

sales of the taxpayer everywhere during the tax period. Sales of tangible personal property are in this state if:

1. The property is delivered or shipped to a purchaser, other than the United States government, or to the designee of the purchaser within this state regardless of the f.o.b. point or other conditions of the sale; or

2. The property is shipped from an office, store, warehouse, factory, or other place of storage in this state and the purchaser is the United States government.

3. Sales, other than sales of tangible personal property, are in this state if the income-producing activity is performed in this state; or the income-producing activity is performed both in and outside this state and a greater proportion of the income-producing activity is performed in this state than in any other state, based on costs of performance.

(4) If the apportionment provisions of this section do not fairly measure the taxpayer's capital in this state, the taxpayer may petition for or the department may require:

(a) The exclusion of any one or more of the factors;

(b) The inclusion of one or more additional factors which will fairly measure the taxpayer's capital in this state; or

(c) The employment of any other method to produce an equitable apportionment of the taxpayer's capital.

(5) No corporation required to pay an annual license tax under this section shall pay less than ten dollars.

HISTORY: 1976 H 549, § 5, eff. 6-19-76

1974 S 179, § 3, H 490, § 1; 1972 H 394, Pt II, § 1; 1970 H 22, § 4; 1966 c 187, Pt II, § 1, c 255, § 129; 1962 c 94, § 1; KS 4189-1, 4189-2, 4189-8



## APPENDIX K

KENTUCKY REVISED STATUTES

**136.290 Report of savings and loan, bank for cooperatives, and production credit associations; value determination; notice**

(1) Every domestic savings and loan association, bank for cooperatives, and every production credit association making loans to members only shall, during January of each year, file with the department of revenue a report containing such information and in such form as the department may require.

(2) The department shall fix the total value, as of January 1 of each year, of the capital stock composed of shares of each savings and loan association and production credit association, excepting the share of borrowing members where the amount borrowed equals or exceeds the amount paid in by those members. The department shall immediately notify each association of the value so fixed.

HISTORY: 1972 H 390, § 2, eff. 6-16-72

1970 H 22, § 2; 1966 c 255, § 130; 1960 c 186, Art I, § 36; 1949 ex s, c 4, § 19; KS 4019a-6

**136.300 Rate and payment of tax; exemption from other taxes; charging against dividends**

(1) By July 1 succeeding the filing of the report provided for in KRS 136.290, each domestic savings and loan association, bank for cooperatives, and each production credit association shall pay directly into the state treasury a tax of one dollar for each one thousand dollars paid in on its capital stock as fixed in KRS 136.290. The individual shareholders shall not be required to list their shares for taxation for any purpose. The association or bank for cooperatives shall not be required to pay local taxes upon

its capital stock, surplus, undivided profits, notes, mortgages, or other credits, and the tax provided by this section shall be in lieu of all taxes for state purposes on property of the association or bank for cooperatives. Failure to make reports and pay taxes as provided in this section and in KRS 136.290 shall subject the association or bank for cooperatives to the same penalties imposed for such failure on the part of the other corporations.

(2) If a domestic savings and loan association, bank for cooperatives, or production credit association so elects, it may deduct taxes imposed in subsection (1) of this section from the dividends paid or credited to a nonborrowing shareholder.

HISTORY: 1972 H 390, § 3, eff. 6-16-72

1970 H 22, § 3; 1966 c 255, § 131; KS 4019a-7, 4019a-8



## APPENDIX L

GENERAL ORDINANCES OF
THE CITY OF LOUISVILLE

**727.05 Returns.**

Each person subject to a license fee imposed by this chapter shall, on or before the fifteenth day of the fourth month following the close of each year, make and file with the Commissioners of the Sinking Fund a return, in duplicate, on a form furnished by or obtainable from the Commissioners of the Sinking Fund, setting forth the aggregate amount of salaries, wages, commissions and other compensation or net profits during the preceding year with such other pertinent information as the Commissioners of the Sinking Fund may require. Provided, however, that where the entire license due under this chapter has been withheld under the provisions hereof, the Commissioners of the Sinking Fund may waive the filing of said return by such licensee. Provided further that where the fiscal year of the business, profession, or other activity differs from the calendar year and licensee files federal income tax return of such other fiscal period the license fee shall be measured by the net profits of the fiscal year and where the return is made for a fiscal year or any other period different from a calendar year, the said return shall be made on or before the fifteenth day of the fourth month following the end of the said fiscal year or other period. Such return shall also show the amount of the license fee imposed by this chapter. (1958 G.O. Sec. 67-6.)

**727.06 Payment.**

The person making the said return shall, at the time of the filing thereof, pay to the Commissioners of the Sinking

Fund the amount of license fees shown as due thereon; provided, however, that where any portion of the license fee so due shall have been deducted at the source, credit for such amount shall be deducted from the amount shown to be due and only the balance, if any, shall be due and payable at the time of the filing of said return, as hereinabove provided; and

provided further it shall be the duty of each employer who has deducted the license fee from the wages, salaries, commissions, or other compensation referred to in Section 727.04 above, to furnish said employee a statement showing the amount of salary earned and license fee deducted and paid by said employer during the preceding calendar year on or before February 15 of each year. (1958 G.O. Sec. 67-7.)